IN THE

Supreme Court of the United States.

GEORGE M. WEST COMPANY, APPELLANT,

versus

LEA BROS. & CO. ET ALS., APPELLEES.

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF FOR LEA BROS. & CO. ET ALS.

EMMETT SEATON, Counsel.

The question certified to this court by the Circuit Court of Appeals for the Fourth Circuit is as follows:

Whether or not a plea that the party against whom a petition in bankruptcy had been filed "was not insolvent as defined in the bankrupt act at the time of the filing of the petition against him" is a valid plea in bar to a petition in bankruptcy filed against a debtor who has made a general deed of assignment for the benefit of his creditors?

Argument.

This question arises under section 3 of the bankrupt law as recently enacted by Congress, and its determination depends upon the construction to be given to that section.

Section 3 of the act is as follows:

"(a) Acts of bankruptcy by a person shall consist of his having (1) conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, any part of his property with intent to hinder, delay, or defraud his creditors, or any of them; or (2) transferred, while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditors over his other creditors; or (3) suffered or permitted, while insolvent, any creditor to obtain a preference through legal proceedings, and not having, at least five days before a sale or final disposition of any property affected by such preference, vacated or discharged such preference; or (4) made a general assignment for the benefit of his creditors; or (5) admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt on that ground.

"(b) A petition may be filed against a person who is insolvent, and who has committed an act of bankruptcy within four months after the commission of such act. Such time shall not expire until four months after (1) the date of the recording or registering of the transfer or assignment when the act consists in having made a transfer of any of his property with intent to hinder, delay or defraud his creditors, or for the purpose of giving a preference as hereinbefore provided, or a general assignment for the benefit of his creditors, if by law such recording or registering is required or permitted, or, if it is not, from the date when the beneficiary takes notorious, exclusive, or continuous possession of the property unless the petitioning creditors have received actual notice of such transfer or assignment.

"(c) It shall be a complete defense to any proceedings in bankruptcy, instituted under the first subdivision of this section, to allege and prove that the party proceeded against was not insolvent, as defined in this act, at the time of the filing the petition against him, and if solvency at such date is proved by the alleged bankrupt, the proceedings shall be

dismissed, and, under said subdivision one, the burden of proving solvency shall be on the alleged bankrupt.

"(d) Whenever a person against whom a petiton has been filed, as hereinbefore provided under the second and third subdivisions of this section, takes issue with and denies the allegation of his insolvency, it shall be his duty to appear in court on the hearing, with his books, papers, and accounts, and submit to examination, and give testimony as to all matters tending to establish solvency or insolvency, and, in case of his failure to so attend and submit to examination, the burden of proving his solvency shall rest upon him.

"(e) Whenever a petition is filed by any person for the purpose of having another adjudged a bankrupt, and an application is made to take charge of and hold the property of the alleged bankrupt, or any part of the same, prior to the adjudication and pending a hearing on the petition, the petitioner or applicant shall file in the same court a bond with at least two good and sufficient sureties, who shall reside within the jurisdiction of said court, to be approved by the court or a judge thereof, in such sum as the court shall direct, conditioned for the payment, in case such petition is dismissed, to the respondent, his or her personal representatives, all costs, expenses, and damages occasioned by such seizure, taking, and detention of the property of the alleged bankrupt.

"If such petition be dismissed by the court, or withdrawn by the petitioner, the respondent, or respondents, shall be allowed all costs, counsel fees, expenses, and damages occasioned by such seizure, taking, or detention of such property. Counsel fees, costs, expenses, and damages shall be fixed and allowed by the court, and paid by the obligors in such bonds."

Appellees in this case contend that a plea of solvency, as defined by the bankrupt act, at the time of the filing of a petition in bankruptcy, is not a valid plea in bar to a petition, filed against a debtor who has made a general deed of assignment for the benefit of his creditors, and in support of that contention they give the following construction to section 3 of the act:

1. That paragraph (a) of said section 3, prescribes the several acts of bankruptcy.

2. That paragraph (b) of said section 3, prescribes the time within which a petition in bankruptcy must be filed.

3. That paragraph (c), of said section 3, prescribes a defence to act of bankruptcy enumerated (1) in paragraph (a) of said section 3, and to no other; and makes it encumbent upon the bankrupt when a petition is filed on that ground to prove his solvency.

3. That paragraph (d) relates to the second and third acts of bankruptcy enumeratrd (2) and (3) in paragraph (a), and requires the bankrupt, when issue in those cases is taken on the question of solvency, to appear in court with his books papers and accounts, and submit to an examination; but does not place upon him the burden of proving his solvency.

4. That no provision whatever is made for the defence of solvency to the acts of bankruptcy enumerated (4) and (5) in said paragrape (a), and supposing the court in all other respects to have proper jurisdiction, there can be none.

The appellant contends that the use of the laguage "*first subdivision*" in paragraph (c) should be construed as applying to and embracing the entire paragraph marked (a), and that the subdivisions of section 3 are *a, b, c, d and e*. They may for some purposes be so considered, but they cannot for the purpose of the appellant in this case; as it would destroy the force and effect of the entire section. While the language "*first subdivision*," as used in the first part of the paragraph, might give some little color to the position taken by the appellant, yet the following language contained at the end of said paragraph obviates any question or doubt as to its true intent and purpose: 'And under *said subdivision one*, the burden of proving solvency shall be on the alleged bankrupt.

From that it is clearly seen that the language *said subdivision one*, is meant to correspond with and embrace the language, *first subdivision* at the beginning of the paragraph; each meaning the same thing.

Putting aside, however, the language of the act, when we apply the provisions of paragraph (c) to either of the acts of bankruptcy enumerated (2) and (3), we find that it has no application whatever, because it raises an issue of solvency as at the time of the filing of the petition in bankruptcy; while the question of solvency under the acts of bankruptcy (2) and (3) would be as at the time of the commission of the act. It is necessary in those two cases that insolvency should exist at the time the act is committed, and, therefore, the question of solvency can be put in issue as readily as can be the commission of the act of bankruptcy itself. By the language of the law it is one of its ingredients. Such is not the case when it is applied to the first act of bankruptcy enumerated (1), as the issue of solvency as at the time of the filing of the petition would not be in conflict with its terms as set forth in the bankrupt act.

If the contention of the appellant is to be sustained, then it is impossible to give any sensible construction to paragraph (d), as (d) would have to be considered as embracing (b) and (c), which cannot be possible. The appellees construe paragraph (d) to relate to acts of bankruptcy numbered (2) and (3), and prescribe what shall be the duty of the alleged bankrupt when in such cases he denies the allegation of his insolvency.

The learned counsel for the appellant contends, that if this construction of paragraph (d) were adopted, that a debtor against whom a petition in bankruptcy had been filed, for having given or allowed a preference, would be forced to produce his books, papers and accounts in court and submit to an examination, while one who had attempted to defraud his creditors, by a fraudulent conveyance, would not be subjected to such an examination or re-

quired to so produce his books, papers and accounts. Such, however, is not the case, but, to the contrary, the position taken by appellant clearly demonstrates that paragraph (d) cannot be construed as embracing paragraphs (b) and (c), for if it does, then it would simply be incumbent upon the bankrupt, who had tried to defraud his creditors by a fraudulent conveyance, to produce his books, papers and accounts in court and submit to an examination. That cannot be, for the reason that paragraph (c) puts upon such bankrupt the burden of proving his solvency; the onus is upon him, and it is not a mere matter of submitting to an examination, he must prove his solvency. If, according to appellant's contention, paragraph (d) embraces both (b) and (c), and (c) refers to and includes each of the acts of bankruptcy enumerated in paragraph (a), then, under paragraph (c), the burden of proving solvency is made encumbent upon every bankrupt against whom a petition in bankruptcy is filed; while, according to the same contention, we find that, under paraghaph (d), the most that could be required of any bankrupt would be to appear in court with his books, papers and accounts and submit to an examination, and in no case could he be made to prove his solvency. Then, in order to properly enforce the bankrupt law, one or the other of these paragraphs must be stricken out, for they are according to that contention, inconsistent.

Another contention of the appellant is that paragraph (b) gives the right to file the petition; paragraph (c) prescribes a defense to such petition; that (d) in no wise refers to (a), and, therefore, it can embrace the two without inconsistency. But are they not still conflicting as to the one upon whom the burden of proof shall be?

The language used in paragraph (c) is as follows: "It shall be a complete defense to any proceeding in bankruptcy, instituted under the *first subdivision* of this section (which appellant construes to mean paragraph (a)), to allege and prove that the party proceeded against was not

insolvent, &c." Appellant says that it is pursuance of paragraph (b) that a bankruptcy proceeding is instituted, yet it in no wise contends that the language in paragraph (c) is in that respect meaningless.

The appellant also says that there is no reason why a plea of solvency, as at the time of the filing of a petition in bankruptcy, should not be allowed to the acts of bankruptcy numbered (2) and (3); because the bankrupt might within four months have regained his solvency. Appellees respectfully submit that such a contention is not a practical one. In the first place, the law does not contemplate that he will regain his solvency within that time. That is the time allowed for the filing of the petition, and not one within which it is supposed he might rebuild his financial condition. If such a plea were allowed, would it not then be encumbent upon the petitioning creditors, who would be endeavoring to catch a rascal, to establish insolvency at the time of the commission of the act, and also at the time of the filing of the petition in bankruptcy?

It would certainly be in the power of the bankrupt to force them to do so. It is not the policy of the law to impose any such undue burden upon the petitioners. Let us see what hardship it would be upon the bankrupt in such case. Has he not by such an act branded himself as a dishonest man? Has he not tried, either by giving or knowingly permitting a preference to one or more creditors, to perpetrate a fraud upon the others? Has he not violated the trust that the bankrupt act has imposed upon him? An insolvent debtor is but a trustee for the benefit of his creditors, and if he acts dishonestly, while he occupies that relation to his creditors, would it be a severe punishment to him to be declared a bankrupt, even though he had accidentally become solvent within the period allowed for the filing of the petition? Had he acted honestly towards his creditors, when in an insolvent condition, then no bankruptcy proceeding could have been instituted against him. Why

should he be entitled to plead solvency at the time of the filing of the petition, and it be insufficient for the petitioners to show insolvency at that time? If he be not proven insolvent, at the time of the commission of the act, the creditors cannot question his after condition for the purpose of having him adjudged a bankrupt. Would he not be given a double advantage over the petitioners?

Appellant, in support of its position, refers to and quotes from sections 18 and 19 of the act as follows:

"Sec. 18. (a) If the bankrupt, or any of his creditors, shall appear within the time limited, and controvert the facts alleged in the petition, the judge shall determine, as soon as may be, the issues presented by the pleadings, without the intervention of a jury, except in cases where a jury trial is given by this act, and make the adjudication or dismiss the petition."

"Sec. 19. (a). Jury Trials. A person against whom an involuntary petition has been filed, shall be entitled to have a trial by jury in respect to the question of his insolvency, except as herein otherwise provided, and any act of bankruptcy alleged in such petition to have been committed, upon filing a written application therefor at or before the time within which an answer may be filed. If such application is not filed within such time, a trial by jury shall be deemed to have been waived."

In answer to this, appellees say, that if in any case it is immaterial to allege insolvency in the petition, then in such case, the above sections have no bearing whatever on the question at issue. Appellant admits that in case of the commission of the fifth act of bankruptcy, that is where the debtor acknowledges, in writing, his inability to pay his debts and expresses a willingness to be adjudged a bankrupt, that by his own act, he has confessed his insolvency, and is, therefore, denied the right of setting up solvency as a defence. Surely, then, in that case the allegation of insolvency is an immaterial one. If so, in that case, why should it not be also when the debtor has made

a general deed of assignment? In substance, the two acts are but the same. There is in each case an acknowledgement by the debtor of his inability to pay his debts, and the act, in either case, certainly places him in such a position, that it is impossible to ascertain whether he is solvent or insolvent, save by a winding up of his estate.

If it had been intended by the law to allow the plea of solvency to one who had made a general deed of assignment for the benefit of his creditors, can any reason be assigned why it did not, as in case of acts of bankruptcy numbered (2) and (3), make insolvency at the time of the execution of the deed, an ingredient of the act? If one has given up all of his property, as the deed in this case recites, then the question of solvency ought properly be one, as at the time of the execution of the deed. Why would not the law also have made some provision, as to the one upon whom the burden of proving solvency should rest, or for the production of debtor's books, accounts and papers? It made such a provision for acts of bankruptcy numbered (1), (2) and (3).

Appellant also says that it would be offering a great premium for fraud if insolvency, at the time of the filing of the petition, were allowed as a plea to one who had committed the first act of bankruptcy and denied to an honest debtor who had surrendered his property for the payment of his debts. Surely that is an anomalous position. Can a creditor question the act of his debtor, so long as that debtor is solvent and has enough assets out of which the creditor can enforce the payment of his debt? Why, then, should not a debtor, against whom a petition in bankruptcy has been filed for having committed the first act of bankruptcy, be allowed to come in and prove his solvency at the time the petition is filed, or, as it were, the allegation made? If he is successful and establishes solvency, he has been guilty of nothing wrong or fraudulent, even though he may have given away a vast portion of his

property; because the creditor still has an ample recourse at law, by which he can enforce the payment of his obligation.

No provision having been made for the defense of solvency as to the last two acts of bankruptcy numbered (4) and (5), the law conclusively presumes, from the debtor's own act, that he is insolvent, and he is prohibited from gainsaying or denying it. Such a view is not so unreasonable as the appellant may suppose, as the very object of the bankrupt law is to give to the creditors, as far as possible, control over the estate of one whose assets are to be administered for the payment of his debts.

The effect of the passage of a bankrupt law by Congress is to supersede all State insolvent laws, from the time of its taking effect; and so far as a State law attempts to administer on the effects of an insolvent debtor and distribute them among his creditors, it is to all intents and purposes an insolvent law.

Bump on Bankruptcy, pages 98 and 99.

Thornhill v. *Bank of Louisiana*, Federal Cases, No. 13,991; *in re Merchants' Insurance Co.*, F. C. 9,441; *in re Independent Insurance Co.*, F. C. 7,017.

Platt v. *Archer*, F. C. 11,213.

Shyrock v. *Bashore*, F. C. 12,820.

It is also to be seen from the definition of insolvency as contained in the act, that the law does not contemplate a plea of solvency in a case of this character. The definition of insolvency under the existing law is as follows:

"A person shall be deemed insolvent within the provisions of this act whenever the aggregate of his property, exclusive of any property which he may have conveyed, transfered, concealed, or removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts."

A general deed of assignment, though made by a sol-

vent person, for the benefit of his creditors, with or without preferences, is fraudulent and void, as the necessary consequence of it is to delay and defraud creditors, by preventing them from subjecting his property, by the ordinary process of law, to the satisfaction of their claims, and the effect of one's act is presumed to have been his intent.

Bump on Bankruptcy, page 239, and *seq.*; *in re Randall*, Federal Cases, No. 11,551; *in re Smith*, Federal Cases, No. 12,974.

It would be necessary, in order that this appellant might sustain its plea of solvency, for it to prove that it has assets, other than what was conveyed by its deed, sufficient to pay its debts, so that its creditors would not be delayed from recovering the amounts due them by process of law. Inasmuch, however, as the deed of assignment executed by it conveys all of its assets, it would be impossible for it to prove that it was not insolvent, as defined by the bankrupt act, at the time of the filing of the petition in bankruptcy.

There can be no question that the fourth act of bankruptcy was included in the present bankrupt statutes for the reason that it has heretofore been so often decided, under all other bankrupt statutes that have ever been in force in this country, that such an act on the part of a debtor is not in keeping with the policy of a bankrupt law. The same reasons for such decisions as existed under former bankrupt statutes exist now.

A deed of assignment is wholly contrary to the policy of a bankrupt law, it divests the bankrupt courts of its jurisdiction and deprives the creditors of the rights given them by the act.

Black on Bankruptcy, p. 20 and *seq.*

In re Gutwillig, p. 475 Federal Reporter, January, 1899.

Boese v. *King*, 108 U. S., 379; *in re Burt*, Federal Cases, No. 2,210.

Cragin v. *Thompson*, Federal Cases, No. 3,320 ; *in re Beisenthal*, Federal Cases, No. 1,236 ; *in re Frisbee*, Federal Cases, No. 5,129 ; *in re Croft*, Federal Cases, No. 3,404 ; *in re Smith*, Federal Cases, No. 12,974.

Appellees insist that under the present bankrupt act, the plea of solvency to a petition in bankruptcy is a valid plea in bar to such petition only in such cases where insolvency is an ingredient of the act, or when it is allowed as a plea by the law, which is not so in case of the execution of a general deed of assignment. The definition of a *petition* as given in section (1) of the act is as follows (20) : "Petition" shall mean a paper filed in a court of bankruptcy or with a clerk or deputy clerk by a debtor, praying for the benefits of this act or *by creditors alleging the commission of an act of bankruptcy by a debtor therein named.*"

Appellees contend that the construction asked for by them is the only reasonable one that can be given, and is the proper construction in order that the object for which the bankrupt law was enacted may be accomplished, and respectfully submit that the decision of the District Court in this case was a right and proper one.

Respectfully submitted.

EMMETT SEATON,

Counsel for Lea Bros. & Co. et. als., Appellees.